

EU Commission Wields Potentially Lethal Shillelagh against Irish Breeding Industry

Those who have any involvement with business strategy will know that a company that wishes to develop a marketing plan ideally carries out a *Situation Analysis* before they start: basically a description of the current market, a SWOT analysis (strengths/weaknesses/opportunities/threats), plus main issues facing the business, and assumptions for the future.

In Ireland this week there would no doubt have been more than one stud farm musing on the 'threats' quadrant of their SWOT analysis. News had just broken that the European Union Commission had declared the Irish tax law that exempts from taxation income from stallion stud fees tax a violation of European competition laws. They followed this announcement with a declaration that the country has just 20 days to provide a decade's worth of details about the tax exemption including an estimate of the cost [to Ireland].

ThoroughbredInternet.com reported that the Commission's 9-page preliminary decision included the comment that "[The Commission] was not aware of the tax law's existence until it received a complaint in May 2003" & notes the exemption "falls under the category of State aid, which is incompatible with the common market because it can distort competition by giving Irish stallions owners a competitive advantage".

Threat No.1 on everyone's SWOT sheet was potentially coming home to roost. Those who potentially stand to lose the most include a name that has revolutionized the commercial breeding market in this part of the world as much as it has in Ireland - the global conglomerate Coolmore.

Beyond its potential impact on those who utilize Ireland as their thoroughbred base due to the financial benefits it avails them, the Commissioner's Report is also interesting reading for its apparent ignorance of an issue that has been the centre of ongoing political (and media) debate since the tax exemption was introduced in the 1960's; certainly since Ireland joined the European Union Commission in 1973.

The Commission may have elected (for reasons unknown) to 'play dumb' on this occasion¹ but the Irish Thoroughbred Breeders Association, the European Breeders Fund and Horse Racing Ireland were obviously privy to a warning of the impending storm. They recently commissioned a Report titled *An Assessment of the Economic Contribution of the Thoroughbred Breeding and Horse Racing Industry in Ireland* from the independent International Economic Consulting Firm Indecon. The purpose of the Report was to conduct an "independent assessment of the economic contribution of the bloodstock and horse racing industry in Ireland and an evaluation of the costs and benefits of the current tax treatment of stallion fee income".

Indecon delivered its draft report in July 2004. Its proposals (despite its apparent independence) were, perhaps, unsurprising.

¹ Despite the tax exemption having predated Ireland's entry into the European Union Commission in 1973 the EU Commission claims the State should have made a formal notification of the exemption after it was extended in 1997; the Department of Finance has apparently known about the omission since February 1999, but no formal notification was ever made.

Background to the tax

In the late 1960s the then Irish Minister for Finance (and former Taoiseach [prime minister]) Charles Haughey introduced tax exemptions for Irish stallion earnings.

The 1960s exemptions were introduced as a means to develop what was then a fledgling industry and indeed, the Irish bloodstock industry has now enjoyed almost forty years of prosperity. It is worthwhile remembering that at the time the tax exemption was introduced Ireland was enjoying a bull economy. Criticism of the tax exemption has increased in recent years as Ireland posts substantial deficits, has reduced its number of civil servants, and supports an increased foreign debt. Lucrative tax exemptions for the 'luxury' end of the market remain harder to justify – at both a social and political level - in such circumstances.

Despite the criticisms Brian Kavanagh (Horse Racing Ireland Chief Executive) told the *Racing Post* in 2002 that “everybody agrees that the tax exemption on stallion fees has been an outstanding success. Ireland is a world leader in racing and bloodstock and this morning there are 25,000 people going to work in the Industry”²

The Irish Bloodstock Industry

Despite the relatively small size of the country, Ireland's bloodstock industry is nowadays one of the largest in the world. The Indecon Report outlines certain key industry findings:

- Ireland is the third largest thoroughbred producer in the world accounting for over 42% of EU output. Bloodstock production accounts for approximately 10 % of all livestock production in Ireland and 4.4% of total agricultural output;
- Total Gross Contribution to the Irish Economy for the breeding sector, including net output and multiplier impacts of sector expenditures is estimated at €330 million
 - Stallion Breeding
 - Total Gross Contribution €132 m
 - Net Income to Economy €7 m to €16.4 m
 - Broodmare Sector
 - Total Gross Contribution €198.4 m
 - Net Income to Economy €108.1 m
- Employment in these sectors on a persons employed basis
 - Stallion Breeding 2,400 persons
 - Broodmare Sector 2,300 persons
- Gross tax contribution of the thoroughbred breeding sector is estimated at €37.5 million per annum

² “Changes in Irish tax law could affect stallion owners” *Thoroughbred Times*, 14 November 2002.

- Ireland had a thoroughbred stallion population of 390 in 2003. The Irish stallion sector includes 89 farms and is characterised by a large number of small to medium-sized farms with a small number of larger farms.
- The broodmare population was 16,938 in 2003. This is an increase from 15,500 mares in 2001, and is more than double the 1984 figure.
- Foal production is increasing and was 10,574 in 2003³.

Exemption vs. unfair advantage

Many would argue - and indeed the research supports the fact - that the entire Irish breeding industry has benefited from the tax exemptions. Similarly, if the tax exemption is removed then the country will lose its competitive advantage and stallions and other bloodstock will potentially (possibly inevitably) be moved to other countries, most notably the United States.

There are those who would suggest however that it is a select few Irish studs that have accrued the lion share of financial benefits bestowed by the exemptions. Stud proprietors who perhaps had a connection with those who implemented the original exemptions have had three decades to leverage commercial benefits and in doing so amass their own personal fortunes at the expense of the local coffers.

One should not underestimate the dramatic effect that very minor changes in the Finance Act would have on these companies' annual profits. And the company who stands to lose the most is Coolmore. An article in the *Sunday Business Post* in February last year stated

"[Coolmore] has a near-monopoly position in the Irish market. The tax exemption introduced by Haughey was designed to assist the fledgling bloodstock industry, but, as the largest operator in the world, Coolmore can no longer be described as 'fledgling'.

What isn't open to question is how extensively Coolmore has benefited from the most generous tax breaks in the world. With the undisputed business brilliance of Magnier and the expertise of his team, the tax breaks have helped to make Coolmore a superpower in the stud business,

Rather like the Irish building materials group CRH, which created a near monopolistic presence in the cement business, Coolmore's domination of the domestic market has enabled it to forge increasingly powerful positions overseas."⁴

³ *An Assessment of the Economic Contribution of the Bloodstock and Horse Racing Industry in Ireland* – prepared by Indecon International Economic Consultants, Draft Briefing Document – July 2004

⁴ "On Rocky Ground", *Sunday Business Post*, The Post.ie, February 8 2004.

John Magnier is one of the wealthiest men in Europe and a man colloquially referred to in downtown Fethard as 'The Boss'⁵. In 1975 Magnier, in association with partners Robert Sangster and Vincent O'Brien, purchased Coolmore Stud in County Tipperary.

"The business plan was based on Magnier's conviction that the big pay-off in racing no longer lay in prize money, but "in the breeding barn. If you don't have the semen," he said "you don't have the industry." Since the best bloodstock was to be found in America, they would buy up the best yearlings there, bring them to Ireland, race them, and develop them into prize stallions at a tax-free profit."⁶

Magnier is a man whose shrewdness and commercial acumen have allowed him to excel in his chosen field but his approach to business dealings has, however, prompted others to occasionally state that "the softest thing about him is his teeth". He is also well known for being somewhat reticent when it comes to press comment. It therefore remains a matter of some conjecture how it came to be that in 1987 Magnier was appointed to the Irish Senate (the second parliamentary chamber); the man instrumental in his appointment being none other than Haughey (whose Gaelic surname Eachaidhe incidentally means 'horseman').

The authors of 1998 article in *The Fethard Observer* were less reticent in their opinion and state that Haughey and Magnier were more than just political acquaintances. The authors go on to say:

"Haughey and Magnier became acquainted through race-meetings and connections within Haughey's party, Fianna Fail ... Among these connections is Haughey's married daughter, Eimear Mulhern, who chairs the Irish Thoroughbred Breeders Association. As a bloodstock agent she has business ties with John Magnier. Magnier, meanwhile, is the son-in-law of Vincent

⁵ Magnier reportedly divides his time between Ireland, Spain, Switzerland and Barbados. Magnier's wealth has spread beyond the thoroughbred industry. In 2001, Magnier teamed with famed Irish gambler John Patrick McManus (a man with extensive thoroughbred holdings in his own right) to buy £30m of shares in Manchester United through their Cubic Expression company. In March 2003, their stake increased to 10.37%, overtaking BSKyB as the club's biggest shareholder and sparking rumours of a takeover bid. *The Sunday Times* Rich List 2004 had Magnier ranked the 6th wealthiest individual in the United Kingdom and reported that the highest auction bid at Christie's last year, £16m for Modigliani's Nu Couche (sur le cote gauche), is believed to have been made in New York by the Irish multi-millionaire. The 2003 Rich List reports Magnier, then 54, controlling the £160m Coolmore empire that has studs in Co Tipperary, Kentucky and Australia. It receives more than £35m a year in stud fees, which are not taxed in Ireland. Most of his assets appear to be held in five offshore tax havens, making it difficult to value business interests that stretch into property, a share in the Sandy Lane hotel in Barbados, leisure and advertising. Very little is known of the beneficial owners of the stud operation. The ultimate holding companies appear to be a Zurich firm Calogo Bloodstock, and Bemak, a company based in the Netherlands Antilles. There are also interests in an Isle of Man company called Linley Investments.

⁶ "The Tough, Dynamic Farmer's Son who Revolutionized the Bloodstock Industry", *Money Week* DIGEST, 14 November 2003.

O'Brien, the famous Irish racehorse trainer, himself a member of the Coolmore syndicate.

"In 1990, 11 Irish passports were granted to the Saudi racing and breeding enthusiast Sheikh Mahfouz and his family in return for a promise to invest £20 million in Irish job-creation schemes. Haughey personally presented the passports to the sheikh over lunch in the Taoiseach's grand mansion at Kinsealy, north of Dublin.

"Because the official certificates for them had yet to be signed by the responsible Minister, the handover was in breach of regulations. Only £17 million of the sheikh's promised £20 million can be traced as having been invested as planned. But £4 million of the £17 million which was invested ended up in a chain of tennis clubs in Britain, in which the biggest shareholder is John Magnier".⁷

Whilst rumours suggest Magnier and Haughey certainly knew of each other at the time that the tax exemptions were introduced I have been unable to find any evidence to verify that fact. The two men certainly enjoyed a mutual interest in thoroughbred horses and Magnier's future political seat and personal fortune arguably benefited from Haughey's 1960's decision to grant tax exemptions to Irish stallion stud fees, but despite this it would be incorrect to infer that Magnier was in any way involved in the conflict of interest that Haughey (also a horse owner at the time the exemptions were introduced) was potentially part of.

At the time the 1998 article was written Coolmore had 50 stallions under management in 5 countries. The company occupied 6000 acres globally and employed 600 staff – 200 of whom worked in Tipperary. As breeding editor of the *Racing Post*, Tony Morris, said in a February 2004 article: "It is very difficult for anyone who wants to stand a stallion to compete with Coolmore."

Tax benefits

The European Union Commission may have hereto been oblivious to the tax exemption and the benefits it had provided to some of the larger Industry players in Ireland, but much of the global thoroughbred community were certainly cognizant of the scheme. Numerous articles have focused on regular political fallout over the exemptions⁸ and the subject is often subject of press comment when a high profile stallion moves to Ireland (most recently demonstrated when seven time G1 winner Rock of Gibraltar retired to stud). In discussing the 2003 dispute that arose between Manchester United

⁷ McCrystal and David Connett "Going gets too hard for racing's fast set" THE OBSERVER (London) Sunday 3rd May 1998 <http://www.fethard.com/reports/obser.html>

⁸ See for example "Changes in Irish tax law could affect stallion owners" *Thoroughbred Times*, 14 November 2002; also "Stallion Tax Exemption in Ireland is threatened", *The Bloodhorse.com*, 18/11/02, http://news.bloodhorse.com/review/nov/nov_9.html

manager Alex Ferguson and Magnier over rights to stud fees for Rock of Gibraltar, the *Irish Post* stated:

"A date in the High Court holds few attractions for Magnier. Going to court would simply publicise Coolmore's operations as never before ... perhaps most potentially damaging for Coolmore, a high-profile court case would focus national and international attention on the massive tax breaks it has enjoyed for over thirty years."⁹

In *Stud: Adventures in Breeding*, US author Kevin Conley was equally upfront about the benefits conveyed by the tax exemption. Reporting on the famous annual bidding duals between Magnier and the Dubai Sheikhs at the Keeneland sales, Conley states (at p.208):

"This advantage (tax exempt Irish stud fees) allows Coolmore to consolidate its hold on the best thoroughbred bloodlines."

Forced to defend the role of the exemptions, the Commission on Taxation released The Second Report of the Commission on Taxation: *Direct Taxation – the Role of Incentives* more than 20 years ago. Note - *twenty years*. This was followed in 2002 by the Irish Thoroughbred Breeders Association (ITBA) stepping forward to respond to disgruntled Irish Labour Party Leader Pat Rabbie's claims that the exemptions were 'scandalous'. The ITBA countered by stating (inter alia)¹⁰:

- Only stallions fees are exempt from tax, all other sections of the Irish bloodstock industry are taxed, and income earned by Irish stallions based overseas is also subject to Irish tax;
- The stallion exemption is the only tax concession received by the bloodstock industry in Ireland, which has much smaller domestic market than the other main breeding countries such as the U.S., Australia, and Japan, which also support their bloodstock industries;
- The stallion exemption has been crucial to the development of the Irish bloodstock industry;
- Total turnover from the sale of Irish nominations is probably less than 100 million euros, not the 300 to 400 million euros suggested elsewhere;
- The Irish bloodstock industry employs 25,000 people, with 5,200 fully dependent on breeding. Half of those jobs would be at risk;
- Before 1969, successful Irish racehorses were sold to America. They now remain in Ireland, which in turn has attracted owners of broodmares to locate and invest. In 2001, there were 15,500 broodmares in Ireland, more than double the 1984 figure;
- Ireland exports 85% of yearlings each year, which produces 140 million in taxable euros; and

⁹ "On Rocky Ground", Sunday Business Post, The Post.ie, February 8 2004.

¹⁰ "Stallion Tax Exemption in Ireland is threatened", *The Bloodhorse.com*, 18/11/02, http://news.bloodhorse.com/review/nov/nov_9.html

- No single Irish stud operation owns more than 15% of the total number of stallions¹¹.

The ITBA may have been attempting to protect the industry as a whole but the 1998 *Fethard Observer* article was far less objective, focusing instead on the benefits that had flowed to specific individuals. The authors' state:

"The Coolmore syndicate's success really swelled in the mid-70's, when it devised a strategy of identifying colts that would become future champion racehorses. Cheaper to buy as yearlings, they were then trained into big winners and subsequently became valuable stallions.

"Thus, for the first time, Magnier, Sangster and O'Brien created a merger of the bloodstock and horse-racing industries. Rich American bloodlines were introduced. To make the new system fail safe they decided to buy only the best yearlings, increasing the chances of winning races and consequently breeding more and more winners. They maximized the scheme when bloodstock values collapsed temporarily in the mid-Eighties.

"By the 1990s Coolmore had created the greatest [line up] of stallions in the world, with branches in North America and Australia. Magnier began to shuttle his stallions to and from Australia, thereby doubling their performance. His animals cover, on average, 25 per cent more mares than do English standing stallions... The joy in the 'Stallion Shuttle' lies in the fact that, since Coolmore benefits from tax-free status, its overseas operations, using Coolmore-based bloodstock, also qualify for Irish tax exemption.

"This is seen both in Australia and other countries – not to mention small Irish stud owners – as giving Coolmore an unfair advantage. What it gains in tax it can spend on buying more and more stallions."

An October 2004 BBC report supports the *Observer's* position on Coolmore's windfall from the tax benefits when it states:

"The winners rolled [for Magnier], and taking full advantage of an Irish law that exempts bloodstock profits from tax, a fortune estimated today at £500m, was accrued.¹²

¹¹ Ibid

¹² C Lysaght "Magnier - The secretive tycoon" *BBC News*, 19/10/2004, http://news.bbc.co.uk/sport1/hi/front_page/3434311.stm

Global effects

In terms of the financial benefits (and consequent market power) that the Irish tax relief provisions have bestowed on Coolmore (and the flow-on effect this has on global bloodstock prices generally), Bill Oppenheim reported in the 11 October 2004 edition of *The Thoroughbred Daily News* that:

“Of the 512 yearlings sold last week in October Part 1, I reckon over 100 of them were bought by Maktoums and associates. John Ferguson, Shadwell and Darley signed for 67, and between Charlie, Anthony Stroud and anybody else who might have been buying for them, I'd say they'll have comfortably broken the 100-yearling mark. That's one of every five sold. Add in Demi's 24, and the game's two biggest operations bought over 25 percent of the yearlings sold last week, and spent over 40 percent of the money. Take the Maktoums out of the equation, and the value of horses in Europe would drop 40 percent overnight. Perhaps just as ominously, 23 of the 24 bought by Demi O'Byrne were by Coolmore stallions, and 17 of the 31 bought by John Ferguson were by Darley/Maktoum stallions--though they did also buy 10 by Coolmore sires.”

It is food for thought for more than just the European Union Commission and the Irish bloodstock industry generally. Remove a tax exemption, and the resultant decrease in power in one of the world's largest thoroughbred conglomerates could have much wider repercussions than just an outstanding amount of unpaid tax to the local exchequer.¹³ Indeed, as our source in Ireland stated earlier this week: “€3 million is small fry compared to Ireland losing its global status as a world leader in the thoroughbred industry and the investments of the likes of Coolmore and Godolphin!”

The ripple effect would affect far more than Europe. Closer to home, Coolmore, with an annual fee income estimated at between AUD\$50-60 million, is by far the largest single player, having displaced Arrowfield Stud and also Woodlands in recent years. Its market domination is however currently being challenged by another global giant - Darley (subsidized by oil rather than tax exemptions). In the recently concluded breeding season Australia (and New Zealand) felt the effects of the two stud farms' Walmart style tussle. In August 2004 *Breeding & Racing's Daily News* reported:

“Former Royal trainer William Huntingdon has provided British readers with a lengthy overview of the new Australasian breeding season, including what racingpost.co.uk describes as “a fascinating insight into the rivalry between Darley & Coolmore”. Huntingdon reported: “Despite the idyllic background of newborn foals gamboling with their dams against

¹³ In support of this view the Indecon Report cites *Bloodstock Breeding: a World Class Irish Industry* (2001) which uses the case of France, where the raising of stallion income taxes in the mid-1970s precipitated the immediate flight of top equine capital from the country, a blow that the French bloodstock breeding industry has yet to recover from.

the wide horizon, all is not peaceful on the studs of Australasia. There have been the usual arguments about the relative merits of the shuttle sire and his colonial rival. The colonial, or local, sire faces strong opposition from the northern hemisphere-based stallion, who often stands at a fraction of his home-country fee." In addition, in 2004, Huntingdon notes: "This year the old rivalries have developed a new twist. Darley and Coolmore are going head-to-head in a fashion the northern hemisphere is only used to in the yearling market. . . .It is akin to a contest between two supermarkets, each seeking to undercut the other."

This week's European Union Commission report states that the Irish tax exemptions "distort competition". Paradoxically, any decrease in Coolmore's Southern Hemisphere influence (particularly with farms such as Vinery decreasing their Australian holdings to concentrate on the lucrative US market) could have massive implications at the local level in terms of employment, property, and bloodstock prices. The local market could also arguably become monopolized by the second of the global breeding 'superpowers' - Darley, ironically cementing the very problem the removal of the tax exemption is said to effect.

Indecon's findings

Indecon's findings were perhaps unsurprising. In a summary that argues that the existing tax exemptions should remain unchanged, Indecon states that changes in the tax treatment of the stallion business would lead to a decline in activity in Ireland. This would have negative implications for income generated in the sector, tax contributions, and the level of employment. They also suggest that the opinion of the Commission on Taxation¹⁴ (1984) remains valid:

"The exemption of such (stallion) fees in Ireland is a major incentive to owners of top-class stallions to stand them in Ireland rather than in the US where more money is available. This results in foreign broodmares being sent to Ireland to be covered by stallions standing in the country, thereby generating foreign earnings and employment.

If the exemption of stallion fees were to be abolished it is probable that foreign-owned stallions would leave Ireland. This would lead to a fall in the quality of Irish-bred horses and would have an adverse effect on the sale of horses.

It is clear that breeding of top class horses is an internationally mobile activity. Ireland has a national advantage in the industry arising from the high reputation and skill of its breeders. The tax regime applying here must take account of that offered in competing countries. The loss to the economy from imposing such taxation could be considerable. The health of the industry

¹⁴Commission on Taxation (1984) Second Report of the Commission on Taxation: *Direct Taxation – The role of Incentives* Pgs 76-77

in Ireland depends to a large extent on a relatively small number of prestige stallions standing here. These are mainly foreign-owned and could be exported without difficulty”.¹⁵

The most surprising finding relates to the cost to the Exchequer of the Stallion Fee tax exemption which is estimated at just €3 million per annum¹⁶, a far cry from political claims in 2002 that exemptions were robbing the government of 100 million euros a year.¹⁷ If such figures are correct (a fact the European Commission may be raising an eyebrow over given Magnier’s rapid ascension of the ‘world’s richest list’ and this week’s request for further particulars) then the exemption may not have had the adverse effect on the Irish economy that others have claimed.

Conclusion

An entire Industry stands to be affected by the European Union Commission’s findings on Ireland’s tax exemptions for stallion service fees. Ireland has certainly enjoyed more than three decades of Industry prosperity courtesy of the exemptions. Certain studs and individuals may, in fact, have prospered more than others. Whilst a recently commissioned report on the economic contribution of the bloodstock and horse racing industry in Ireland and an evaluation of the costs and benefits of the current tax treatment of stallion fee income may have recommended that the current system remain unchanged, it may be that Ireland’s ‘protected’ status is about to change, thus potentially signaling a major shift in investment (and global buying power) as investors worldwide reassess the competitiveness of the Irish market compared to others, most notably the United States.

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¹⁵ “Summary of Key Findings” An Assessment of the Economic Contribution of the Bloodstock and Horse Racing Industry in Ireland – prepared by Indecon International Economic Consultants, Draft Briefing Document – July 2004, p. 4

¹⁶ *ibid* p. 2

¹⁷ “Stallion Tax Exemption in Ireland is Threatened”, *Bloodhorse.com*, 11/8/2002.
http://news.bloodhorse.com/review/nov/nov_9.html